

Weekly Investment Commentary

Markets Recover Some Ground As Uncertainty Remains High

August 29, 2011

Stocks Bounce Higher

Stocks reversed course last week and experienced sharp increases, with the Dow Jones Industrial Average climbing 4.3% to 11,285, the S&P 500 Index rising 4.7% to 1,177 and the Nasdaq Composite advancing 5.9% to 2,480. As we said last week, the market appears to be in a volatile trading pattern of between 1,100 on the downside for the S&P (the low reached August 9) and 1,250 on the upside, a previously important technical low and now an important high.

Recession Still Unlikely, But Growth Will Remain Weak

Market volatility continues to be driven over concerns about the possibility of recession in the United States and in Europe. Real gross domestic product (GDP) in the United States grew by around 1% in the first half of the year, a rate just above stalling and one that contributes to worries about the state of the economy. Although we acknowledge the downside risks, we continue to believe that a US recession is not in the cards.

One somewhat bright spot is that gross domestic income (GDI) in the United States grew faster than GDP over the first six months of 2011. GDI is an equally valid measure of the state of the overall economy, and this difference suggests the possibility that GDP data may yet be revised higher. In addition, if the US economy were about to fall into recession, we would likely be seeing weakness in unemployment claims, capital expenditures and corporate profits, none of which is occurring. As a result, we do not believe a recession will be forthcoming anytime soon.

This is not to suggest that growth levels are likely to rebound, however. GDP in the major world economies have been growing at below-trend levels for the past several quarters, and growth rates are likely to remain sluggish. The world has not fully recovered from the effects of the credit crisis and tighter financial conditions in many parts have been holding back growth. The downside has also been exacerbated by doubts over the possibility of fiscal policy and/or monetary stimulus to break the circle between weakness in the global economies and markets.

In some ways, whether or not the economy does sink into recession is a technical point. If we do see a double-dip recession, any such contraction should be mild. If the economy avoids a recession, growth will still be weak. From an earnings perspective, any decline that comes about in earnings growth due to economic weakness should also be smaller than the average contraction that occurs during a typical recession. Looking ahead, our forecast is that earnings growth flattens out while GDP remains very low.

No New Action Expected From the Fed

While expectations had been growing that the Federal Reserve would signal additional quantitative easing measures, those expectations faded somewhat by Friday when Fed



Bob Doll is Chief Equity Strategist for Fundamental Equities at BlackRock®, a premier provider of global investment management, risk management and advisory services. Mr. Doll is also Lead Portfolio Manager of BlackRock's Large Cap Series Funds. Prior to joining the firm, Mr. Doll was President and Chief Investment Officer of Merrill Lynch Investment Managers.

"Although we acknowledge the downside risks, we continue to believe that a US recession is not in the cards."

Chairman Ben Bernanke delivered his highly anticipated speech at Jackson Hole. Mr. Bernanke was fairly noncommittal in his remarks and the markets barely reacted to his comments. During his speech, Mr. Bernanke devoted a great deal of his remarks to urging Washington to put the country's fiscal position on a sustainable path. In short, he seemed to suggest that politicians begin pulling their own weight.

At this point, we are not anticipating that additional easing measures (beyond keeping rates extremely low) will be forthcoming. There is some disagreement within the Fed over what should be done, the political environment surrounding Fed action has turned contentious and core inflation has moved up somewhat. As a result, we do not believe the Fed will be taking additional action unless renewed deflation risks emerge.

"We do not believe the Fed will be taking additional action unless renewed deflation risks emerge."

Any Help on the Political Front?

Although President Obama has indicated that he would like to see a new stimulus and jobs plan to help the troubled economy, we do not believe that any such program is likely given the current political backdrop. Meanwhile, members of the staff of the so-called "super committee" charged with identifying deficit reduction options have been indicating that they may be coming to some sort of understanding. This may be an overly optimistic view, but we do think there is a reasonable chance that the super committee could arrive at a deal by their October 23 deadline, particularly since senior members of the Democratic and Republican parties appear to understand that failure is not an option.

Stocks Attractively Valued

Since the Great Recession, equity markets have been hit by a huge risk premium, and this premium seems to be getting larger as a result of political squabbles in the United States, policy paralysis in Europe and the poor performance of key economic indicators around the world. Unless and until the uncertainty around these issues fades, stock multiples could easily remain depressed.

In any case, however, we do believe that stocks remain quite attractive, particularly compared to alternatives. The dividend yield on the S&P 500 Index exceeds the yield of the 10-year Treasury. Such time periods are rare, and when they occur they are typically followed by good equity returns. We are hopeful that that also happens this time.

For additional information, or to subscribe to weekly updates to this piece, please visit www.blackrock.com.

Sources: BlackRock; Bank Credit Analyst. This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of August 29, 2011, and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Past performance is no guarantee of future results. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

FOR MORE INFORMATION: www.blackrock.com

BlackRock is a registered trademark of BlackRock, Inc. All other trademarks are the property of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

©2011 BlackRock, Inc. All Rights Reserved.

Not FDIC Insured • May Lose Value • No Bank Guarantee
--